STATE OF UTAH INSURANCE DEPARTMENT

REPORT OF EXAMINATION

OF

EDUCATORS MUTUAL INSURANCE ASSOCIATION OF UTAH
OF
MURRAY, UTAH

AS OF

DECEMBER 31, 2001

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June 24, 2003

Honorable Merwin U. Stewart, Commissioner
State of Utah Insurance Department
State Office Building, Room 3110
Salt Lake City, Utah 84114-6901

In accordance with your instructions and in compliance with Utah Code Annotated (U.C.A.) Title 31A, an examination of the financial condition and business affairs of

EDUCATORS MUTUAL INSURANCE ASSOCIATION OF UTAH
Of
Murray, Utah

a nonprofit mutual life insurance company, hereinafter referred to as the Association, was conducted as of December 31, 2001.

SCOPE OF EXAMINATION

Period Covered by Examination

The Utah Insurance Department's ("Department") last financial examination of the Association was conducted as of December 31, 1999. The current examination covers the period from January 1, 2000, through December 31, 2001, including any material transactions and/or events occurring subsequent to the examination date noted during the course of the examination. The Association's wholly owned subsidiary, Educators Health Care, was examined concurrently.

Examination Procedure Employed

The examination included a general review and analysis of the Association's operations and a determination of its financial condition as of December 31, 2001. The examination was conducted in accordance with generally accepted standards and procedures of regulatory authorities relating to such examinations. It included tests of the accounting records and a review of the Association's affairs and practices to the extent deemed necessary. Permitted assets and required liabilities were valued in accordance with laws, rules, and procedures prescribed by the State of Utah.

The Association retained the services of a certified public accounting firm to audit its financial records for the period under examination. The firm provided requested working papers prepared in connection with its audits. The firm's working papers were given consideration in adoption of the examination plan and procedures, but did not significantly affect the nature and extent of examination procedures performed. The firm's correspondence regarding pending or threatened litigation, claims, and assessments received from the Association's legal representatives was relied on.

The examination relied on Milliman USA Consultants and Actuaries' calculations of aggregate reserves for life and certain accident and health policies. Examiners reviewed the actuarial report and working papers for reasonableness of the methodology employed and the conclusions reached. In addition, examiners tested the completeness of the records provided to the firm, and the accuracy of the underlying data used to establish reserve amounts.

A letter of representation certifying that management has disclosed all significant matters and records was obtained from management and has been included in the examination working papers.

Status of Adverse Findings, Material Changes in the Financial Statement, and Other Significant Regulatory Information Disclosed in the Previous Examination

The previous examination reduced reported surplus by $4,120,648. The reduction resulted primarily from a decrease in the value of a subsidiary in the amount of $1,191,166, an increase in accident and health policy and contract claims in the amount of $1,553,458, the establishment of a reserve for unpaid claims adjustment expenses in the amount of $753,750, and a nonadmitted receivable in the amount of $481,691. The adjustments resulted in the Association incurring an authorized control level event as defined in U.C.A. § 31A-17-605.

As of the current examination date, the Association's total adjusted capital significantly exceeded the Risk-Based Capital trigger point for regulatory action. (Refer to **CAPITAL AND SURPLUS**) Important points and recommendations noted in the prior examination report have been addressed by the Association or have received further comment in this report.

HISTORY

General

The Association was organized on June 16, 1935, as a non-profit mutual benefit association. The Utah Education Association, an organization of Utah educators, sponsored and participated in the creation of the Association in order to provide insurance protection to educators. The Association's original name was Utah Teachers Welfare Association. The name was changed to its present name on October 7, 1965. In 1994, the Association filed a business name registration application with the State of Utah Division of Corporations and Commercial Code to record a "doing business as" (D.B.A) Educators Mutual Insurance Association.

The Association operates under U.C.A. § 31A-5-108. The Association is authorized to transact life, annuity, and accident and health lines of insurance. No changes were made to the Association's articles of incorporation or Bylaws during the examination period.

Membership

The Association's articles of incorporation require that members be individuals employed by Utah public school districts, institutions of higher education, other agencies or political subdivisions primarily engaged in public educational activities, or employees of organizations comprised of public education employees.

Management

The Association's Bylaws set the number of directors at fifteen. The members of the Association elected twelve directors and the elected directors appoint three directors. Subsequent to the examination date, adopted Bylaws created one additional appointed position. Any vacancy occurring may be filled by a majority vote of the directors. Directors serving on December 31, 2001, were:

Name –Residence	Type	Principal Occupation
Arlene Arnold Orem, Utah	Elected	Uniserv Director, Utah Education Association
Corey W. Callahan American Fork, Utah	Elected	Benefits Manager, Utah Valley State College
Michael R. Evans Fillmore, Utah	Elected	Teacher, Millard School District
James C. Fontaine Salt Lake City, Utah	Appointed	Retired. Previous position: CFO and Senior Vice President, Deseret Mutual Benefit Administrators
Lynette Grow Riverdale, Utah	Elected	Teacher, Weber School District
Wallace G. Harmer Salt Lake City, Utah	Elected	Business Administrator, Salt Lake City School District
Mike W. Hepner Draper, Utah	Elected	Executive Director, Utah School Employees Association
Nancy R. Jensen Centerfield, Utah	Elected	Retired
Susan M. Kuziak Salt Lake City, Utah	Elected	Executive Director, Utah Education Association
Timothy A. Leaman Paradise, Utah	Elected	Teacher, Cache County School District
Randall R. Smart Sandy, Utah	Appointed	Attorney, Snow Nuffer, et al.
James M. Thompson Price, Utah	Elected	Teacher, Carbon High School
Scott C. Thornton Centerville, Utah	Appointed	Chief Actuary, Deseret Mutual Benefit Administrators
Carol L. Winters Orem, Utah	Elected	Accounting Assistant, Alpine School District

On December 20, 2001, the board was notified that Leonard F. Miller had resigned his position on the board. Wallace G. Harmer was appointed to serve the remaining one-year of Mr. Miller's term. At the November 10, 2001, annual membership meeting, Mike W. Hepner, Susan M. Kuziak, James M. Thompson, and Carol L. Winters were reelected to three-year terms of office. R. Paul Gottfredson, Utah Association of School Business Officials, was elected to an initial three-year term.

Board committee members as of December 31, 2001, were:

Executive Committee	Audit Committee
Wallace G. Harmer, Chair	Carol L. Winters, Chair
Susan M. Kuziak, Vice Chair	Arlene Arnold
James C. Fontaine	Wallace G. Harmer
Mike W. Hepner	Nancy R. Jensen
Carol L. Winters	James M. Thompson
Rolando I. Galano	

Budget Committee	Legislative Committee
James C. Fontaine, Chair	Mike W. Hepner, Chair
Corey W. Callahan	Lynette Grow
Michael R. Evans	Susan M. Kuziak
Timothy A. Leaman	Randall R. Smart
Scott C. Thornton	

Officers serving the Association as of December 31, 2001, were:

Officer	Office
Rolando I. Galano	President/Chief Executive Officer
David S. Glauser	Vice President, Secretary-Treasurer
Ralph L. Colossimo	Vice President
Reagan S. Wood	Vice President
Jennifer Q. Gallegos	Vice President
Charlotte B. Poulsen	Vice President

In July 2002, Mr. Colossimo resigned from his position as Vice President of Group Marketing. Steve Morrison, the former internal auditor was subsequently appointed Vice President of Marketing.

Conflict of Interest Procedure

The Association has a formal conflict of interest policy and procedure that requires employees to avoid any conflict of interest between the Association and a personal business where the employee could gain personally from the relationship.

All officers and directors filed conflict of interest disclosure statements. The statement requested that the employee certify that he/she does not have any interest that conflicts or may conflict with his/her duties or judgment or list the interests that may give actual or potential conflict with his/her duties or judgment. Six of the directors listed an employer and position with an educational institution. One director listed three health related clients. One director filed an incomplete statement, which did not identify whether any conflict of interest exists or may exist.

Corporate Records

In general, the minutes of meetings of members, directors, and committees adequately approved and supported the Association's transactions and events. A notable exception was that the board of directors did not appoint two vice presidents hired during the examination period. Subsequent to the examination date, board of directors' minutes were amended to reflect that the last state examination report was given to each board member, as required by U.C.A.§ 31A-2-204(8).

Acquisitions, Mergers, Disposals, Dissolutions and Purchase or Sales through Reinsurance

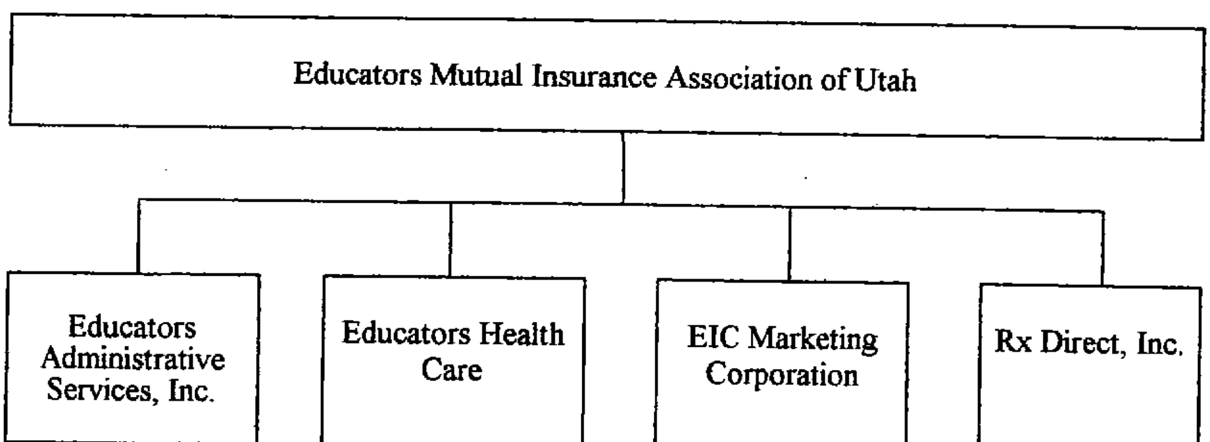
In a letter, dated December 28, 2000, the Association's subsidiary, Educators Insurance Company, now known as Educators Administrative Services, Inc., notified the Department that it was surrendering its certificate of authority effective immediately. The Department dissolved the company's insurance component on March 8, 2001.

Surplus Debentures

The Association did not issue or retire any debentures during the examination period nor were any surplus debentures outstanding as of the examination date.

AFFILIATED COMPANIES

The Association is a member of an insurance holding company system as shown in the following organizational chart as of December 31, 2001.



Educators Administrative Services, Inc. ("EASI"), formerly Educators Insurance Company, is a Utah for-profit corporation, licensed as a third party administrator of life and accident and health insurance. Educators Health Care ("EHC") is a Utah domiciled non-profit health maintenance organization. EIC Marketing Corporation ("EICMC") is a for-profit brokerage firm organized to market insurance and employee benefit products. Rx Direct, Inc. ("Rx") is a for-profit prescription benefit management company.

Under the terms of an agreement entered into in 1988, the Association provided for the total operation of EASI through December 31, 2000. Under the terms of a management agreement dated July 9, 2001, with an effective date of January 1, 2001, the Association provided administrative services to EASI with respect to third party administration. Services provided under the agreements were subject to the general supervision, review, control and direction of EASI's board of directors. The agreements required EASI to reimburse a percentage of the gross annual salaries and benefits of certain Association employees. In addition, EASI was required to pay an administrative fee based upon a percentage of the gross annual premium and service income. The 2001 fee was 6.79 percent.

In 1998, the Association entered into an agreement to provide marketing and administrative services to EHC. In consideration for the services and the use of the Association's panel providers, EHC was required to pay the Association .075 percent of all premiums received. The agreement was amended on December 28, 2001, to require EHC to pay a sum equal to 9.2 percent of all dental premiums received by EHC.

In 1999, the Association entered into an agreement to provide management services to EICMC. EICMC agreed to pay a fee of $57,040 plus 18.27 percent of its annual revenue. On January 3, 2000, with an effective date of January 1, 2000, the agreement was amended to require EICMC to pay 10 percent of EICMC's revenue per annum.

In 1997, the Association entered into an agreement to provide administrative and management services to Rx. Effective January 1, 1999, Rx was required to reimburse the Association for a percentage of the gross annual salaries and benefits of certain Association employees and for any general expenses incurred by the Association for Rx. In addition, Rx was required to pay an administrative fee equal to 31.61 percent of net of drug cost revenues including investment income earned by Rx. On January 2, 2001, the required administrative fee was amended to equal 5 percent of net of drug cost revenues including investment income earned by Rx.

The Association did not notify the Commissioner in writing of its intention to enter into the 2001 EASI management agreement nor was the Commissioner notified of the amendments to the other management agreements at least 30 days prior to entering into the agreement and amendments as required by U.C.A. § 31A-16-106(1)(b)(iv). A Form D, Prior Notice of a Transaction, with regard to the EHC amendment was filed in September of 2002.

Service fees received under management service agreements follow:

Affiliate	1999	2000	2001
Educators Administrative Services, Inc.	$ 679,430	$283,382	$ 68,668
Educators Health Care	81,624	44,278	279,440
EIC Marketing Corporation	64,460	3,306	3,286
Rx Direct, Inc.	175,102	31,159	26,435
Totals	$1,000,616	$362,125	$377,829

The Association's investments in its subsidiaries as of the examination date were:

	Cost	Admitted Value
Educators Administrative Services, Inc.	$2,795,500	$2,836,148
Educators Health Care	330,000	0
EIC Marketing Corporation	1,000	47,029
Rx Direct, Inc.	1,000,000	12,646
Totals	$4,126,500	$2,895,823

FIDELITY BONDS AND OTHER INSURANCE

The minimum fidelity insurance suggested by the National Association of Insurance Commissioners ("NAIC") for a company of the Association's size and premium volume was $500,000 to $600,000. The Association was a named insured under a financial institutional bond providing coverage up to a single loss limit of $800,000 with a deductible of $25,000. Directors' and officers' liability insurance had an aggregate limit of $1,000,000. The Association was a named insured under property, general liability, and workers' compensation policies.

PENSION, STOCK OWNERSHIP, AND INSURANCE PLANS

The Association is a participant in defined benefit retirement plans sponsored by Utah Retirement Systems. The plans are qualified tax-deferred plans under the Internal Revenue Code. During the examination period, the Association's required contributions were 11.9 percent or 10.4 percent of an eligible employee's salary depending on whether the employee elected to participate in the contributory or noncontributory retirement plan. In addition, after one year of employment the Association made a two-percent of salary contribution to a 401(k) tax-deferred plan for eligible employees. The Association's contributions vest at 20 percent per year beginning with the second year of vesting service.

The Association also provides postretirement benefits other than pensions for retired employees. Substantially all employees may become eligible for benefits if they reach retirement age while working for the Association. A liability in the amount of $780,747 was included in the December 31, 2001, financial statement for accumulated postretirement benefits other than pensions.

Employer paid medical, dental and prescription card insurance was provided to employees and eligible dependents. Employer paid vision, long-term disability, and workers' compensation insurance was provided only to employees.

Employer paid term life insurance in the amount of $20,000 or in an amount equal to the employee's annual salary if the employee's salary exceeded $20,000, was provided to employees.

Employer paid dependent term life insurance in the amount of $2,420 was also provided for each eligible dependent.

STATUTORY DEPOSITS

Pursuant to U.C.A. § 31A-4-105, the Association was required to maintain a statutory deposit of $400,000. Key Bank held U.S. Treasury Notes with a par value of $1,000,000 and a statement value of $1,018,710 under a tri-party agreement with the Department. The deposit was held for the benefit of all policyholders, claimants, and creditors of the Association.

INSURANCE PRODUCTS AND RELATED PRACTICES

Policy Forms and Underwriting

A concurrent market conduct examination compared the Association's list of Department filings with forms filed with the Department. No discrepancies were noted. The Association's maximum retained risk for any single individual was $300,000.

Territory and Plan of Operation

As of the examination date, the Association was authorized to conduct life, annuity and accident and health insurance business only in the State of Utah. No life or annuity policies were issued during the examination period. The Association issued comprehensive medical, dental, long and short-term disability and waiver of premium policies. In addition, the Association assumed 100 percent of accident and health policies, other than dental from EHC.

During the examination period, the Association transitioned its accident and health medical plan of operation from fully insured plans to self-funded Administrative Service Only ("ASO") and Administrative Service Contract ("ASC") plans with specific and aggregate stop loss insurance coverage available. Although a few groups retained fully insured accident and health plans, most of the Association's business moved from fully insured plans to ASO or ASC plans. With a few exceptions, the groups elected specific and aggregate stop loss coverage for claims in excess of certain specific and aggregate attachment points as set forth in each group policy.

The Association marketed its products through an affiliated brokerage firm on a personal contact basis. In addition, the Association provided seminars, training sessions, and faculty meetings with employer groups.

Advertising and Sales Material

Sales material was reviewed in a concurrent market conduct examination. The material included packets given to potential clients and to employees after enrollment into a plan. No material exceptions were noted in a comparison of sales materials to related policies.

Treatment of Policyholders

Complaint handling procedures and a sample of complaints were reviewed in the concurrent market conduct examination. The examination determined that the Association maintains some control over policyholder complaints and that policyholders were being treated fairly. Forty complaints were filed with the Department in year 2000. Fourteen were filed in 2001.

The Association had written grievance procedures in place. An insured could request a review of a claim that had been denied by writing to the claims review committee. If the insured did not agree with the findings of this committee, the insured could request a review by the executive committee. If dissatisfied with the decision of the executive committee, the insured could request a review by the board of directors. If still dissatisfied, the insured could make a written request for arbitration. Arbitration was final if the amount in question was greater than the jurisdiction of the small claims court. The insured was required to exhaust all administrative remedies before initiating any action in small claims court.

REINSURANCE

Assumed

Effective January 1, 1999, the Association entered into an agreement with EHC to assume 100 percent of certain group medical plans issued to educational groups and affiliated organizations. EHC agreed to pay premiums monthly, in arrears, in accordance with the following net rates:

Minimum:	99 percent of total direct premium
Provisional:	100 percent of total direct premium
Maximum:	101 percent of total premium

The final premium for each calendar year the agreement is in effect is based on insured claims through the end of the calendar year. It is determined by multiplying EHC's incurred losses applicable to the reinsurance period by 100/90. The final premium is subject to the minimum and maximum premiums shown above. The premiums are not subject to commissions or expense allowances. The following schedule reflects reinsured premiums:

1999	2000	2001
$97,456,735	$59,311,882	$6,856,453

Ceded

As of the examination date, two specific medical excess of loss reinsurance agreements with General & Cologne Life Re of America were in effect. The first excess treaty provided coverage in excess of $300,000 per person, per agreement year, not to exceed an amount of $700,000 per person, per agreement year. The second excess treaty provided coverage in excess of $1,000,000 per person, per agreement year, not to exceed $1,000,000 per person, per agreement year.

ACCOUNTS AND RECORDS

The Association's accounting system utilized a centralized computer record processing system, supplemented by ancillary records maintained manually or on personal computers. An examination trial balance, as of December 31, 2001, was prepared from an electronic copy of the Association's general ledger. Account balances were traced to annual statement exhibits and schedules without exception. Individual account balances for the examination period were examined as deemed necessary.

Accounts and records deficiencies included the following:

- The Association did not have a disaster recovery plan in effect. In addition, copies of computer programs, essential documents, records, and files were not stored in an off-premises location.
- The following annual statements exhibits, schedules, note, form and supplement were not prepared in accordance with annual statement instructions as required by U.A.C. § R590-147:
    - Exhibit of Life Insurance: Incorrect information and amounts were reported.
    - Analysis of Operations by Lines of Business (Gain and Loss Exhibit), Exhibit 5, and Exhibit 6: Uninsured accident and health plan business was incorrectly reported as a line of business and included under the headings "Aggregate of All Other Lines of Business" or "All Other Lines of Business". Uninsured accident and health plans are a component of the Accident and Health line of business and should be reported as such.
    - Schedule A, Part 1, Columns 5 and 9: Date of last appraisal and fair value of real estate holdings were not reported.
    - Form for Calculating the Interest Maintenance Reserve ("IMR"): Prior years adjustments for preferred stock realized gains and losses were improperly reported in column 3. In addition, the seriatim IMR method was used to calculate the amortization of bond gains and losses and the grouped method was used to calculate the amortization of preferred stock gains and losses. Companies may select either the seriatim method or the grouped method, but may not use both methods in the same calendar year.
    - Schedule D: Provisionally exempt securities, meeting the criteria set forth in the Purposes and Procedures Manual of the NAIC Securities Valuation Office, were not designated with the administrative symbol PE.

- Schedule S, Part 3, Section 1: Current year reserve credit does not equal reinsurance reserve credit claimed on Exhibit 8, Aggregate Reserve for Life Policies and Contracts.

- Schedule S, Part 6: Restatement adjustments were not reported.

- 2001 annual statement Schedule T: The Association reported that it was licensed in Idaho. The Idaho license was surrendered in 2001.

- Schedule Y, Part 2 – Summary of Insurer's Transactions with any Affiliates: Transactions with noninsurance affiliates were not reported. Administrative service agreement amounts reported for EHC are not correct.

- Accident and Health Policy Experience Exhibit for Year: Detail provided and summary amounts are not in agreement. Neither detail amounts nor summary amounts agree with amounts reported in Annual Statement, Exhibit 1, Part 1.

- Annual statement Note to Financial Statements number 26 did not adequately disclose required information.

- Securities acquired through a broker were held by the broker for up to eleven months before being transferred to a custodial account. U.C.A. § 31A-4-108 requires an insurer to hold all investments in its own name except securities kept under a custodial agreement or trust arrangement and securities that may be acquired and held in bearer form. Subsequent to the examination date, instructions were issued to the broker to transfer the securities to a custodial account in a timely manner.

- Administrative sweep accounts specified, by NAIC Accounting Practices and Procedures SSAP No. 2, as meeting the definition of cash equivalents were improperly reported as short-term investments.

- Section I(9) of uninsured health plan administrative services agreements requires the Association to:

> At least once a year, at the end of the plan year, provide a full accounting showing total remittances made by Plan Sponsor, prior cash beginning balances, claims paid, administrative fees charged, reinsurance premiums charged, any other charges, and ending fund reserve balances. The report will also show an estimate of incurred but not reported (IBNR) claims liability determined by actuarial trained staff.

Statements containing the above information were not provided to Plan Sponsors during the examination period.

- The Association should establish an unearned administrative expense liability for costs expected to be incurred in connection with the recording and adjustment of unpaid uninsured accident and health plan claims.

FINANCIAL STATEMENTS

The Association's financial condition as of December 31, 2001, and the results of its operations during the twelve months then ended, as determined by examination, are reported in the following financial statements:

Balance Sheet as of December 31, 2001
Summary of Operations – January 1, 2001 through December 31, 2001
Surplus – January 1, 2000 through December 31, 2001

The accompanying Comments on Financial Statement are an integral part of these statements.

Educators Mutual Insurance Association of Utah
Balance Sheet
As of December 31, 2001

ADMITTED ASSETS

	Amount	Notes
Bonds	$23,055,577	
Preferred stocks	4,581,494	
Common stocks	2,895,823	(1)
Real estate: Properties occupied by the company	1,391,629	(2)
Cash and short-term investments	14,366,399	(3)
Electronic data processing equipment and software	79,174	
Life insurance premiums and annuity considerations deferred and uncollected	270,000	(4)
Accident and health premiums due and unpaid	198,434	
Investment income due and accrued	434,861	
Receivable from parent, subsidiaries and affiliates	267,409	
Amounts receivable relating to uninsured accident and health plans	657	(5)
Aggregate write-ins for other than invested assets: Accounts receivable	388,801	
Total assets	$47,930,258	

Continued on the following page.

Educators Mutual Insurance Association of Utah
Balance Sheet (continued)
As of December 31, 2001

LIABILITIES

Aggregate reserve for life policies and contracts	$ 1,339,496	(6)
Aggregate reserve for accident and health policies	10,351,491	(7)
Liability for deposit-type contracts	0	(8)
Policy and contract claims – life	20,976	(9)
Policy and contract claims -- accident and health	12,301,568	(10)
Premiums and annuity considerations for life and accident and health policies and contracts received in advance	311,490	(11)
Other amounts payable on reinsurance	94,855	(12)
Interest maintenance reserve	1,347,830	
General expenses due or accrued	1,493,160	(13)
Taxes, licenses and fees due or accrued, excluding federal income taxes	19,329	
Amounts withheld or retained by company as agent or trustee	1,309,963	(14)
Remittances and items not allocated	28,121	(15)
Liability for benefits for employees and agents if not included above	0	(16)
Asset valuation reserve	780,893	
Payable to parent, subsidiaries and affiliates	75,449	(17)
Liability for amounts held under uninsured accident and health plans	4,975,841	(18)
Aggregate write-ins for liabilities:		
Accounts payable	33,307	(19)
Reinsurance payable	0	(20)
Total liabilities	34,483,769	
Unassigned funds (surplus)	13,446,489	(21)
Total liabilities and surplus	$47,930,258	

Educators Mutual Insurance Association of Utah
Summary of Operations
January 1, 2001 through December 31, 2001

	Amount	Notes
Premiums and annuity considerations for life and accident and health policies and contracts	$ 47,079,499	(4)
Net investment income	2,208,453	
Amortization of interest maintenance reserve	67,635	
Aggregate write-ins for miscellaneous income:		
Service and miscellaneous income	643,421	
Total	49,999,008	
Death benefits	(42,907)	(9)
Disability benefits and benefits under accident and health policies	47,638,836	
Surrender benefits and withdrawals for life contracts	655	
Increase in aggregate reserves for life and accident and health policies	2,851,774	(6)(7)
Total	50,448,358	
Commissions on premiums, annuity considerations and deposit-type contract funds	107,131	
Commissions and expense allowances on reinsurance assumed	18,906	
General insurance expenses	26,253	
Insurance taxes, licenses and fees, excluding federal income taxes	364,565	
Increase in loading on deferred and uncollected premiums	132,300	(4)
Total	51,097,513	
Net income	($ 1,098,505)	

Educators Mutual Insurance Association of Utah
Surplus
January 1, 2000 through December 31, 2001

	2000	Per Exam 2001
Surplus December 31, prior year	$ 10,535,511	$13,946,155
Net income	3,902,539	(1,098,505)
Change in net unrealized capital gains (losses)	(145,297)	411,512
Change in non-admitted assets and related items	(428,849)	564,132
Change in asset valuation reserve	82,251	(376,805)
Net change in surplus for the year	3,410,644	(499,666)
Surplus, December 31, current year	$ 13,946,155	$13,446,489

COMMENTS ON FINANCIAL STATEMENT

(1) Common stocks **$ 2,895,823**

The reported amount, $2,809,175, was increased by $86,648. The increase in the admitted value resulted from using the Generally Accepted Accounting Principles (GAAP) equity method to value the Association's noninsurance subsidiaries. NAIC Accounting Practices and Procedures Manual ("APPM") SSAP No. 46 specifies that this method applies if a noninsurance subsidiary has significant operations aside from holding assets of the parent company.

(2) Real estate **$ 1,391,629**

The reported amount, $1,426,079, was decreased by $34,450. The depreciated book value of the basement and common areas of the Association's former office building was not admitted in accordance with NAIC APPM SSAP No. 40. The fair value was determined to be $0. SSAP No. 40, Section 9 states: "If the fair value of the asset is less than the carrying value, the asset shall be written down to the fair value thereby establishing a new cost basis."

(3) Cash and short term investments **$ 14,366,399**

The amount reported, $14,457,876, was decreased by $91,477. An incorrect accounting entry that overstated cash and accounts payable was reversed.

(4) Life insurance premiums and annuity considerations deferred and uncollected **$ 270,000**

In accordance with NAIC APPM SSAP No. 51, net premiums included in the computation of the aggregate reserve for life polices "taken over" by Johnson Rooney Welch, Inc. were setup to offset the overstatement of policy reserves. Premium income was increased by gross premiums in the amount of $402,300. In accordance with NAIC APPM SSAP No. 51, the change in loading in the amount of $132,300 is included as an expense in the summary of operations.

(5) Amounts receivable relating to uninsured accident and health plans **$ 657**

The amount reported, $8,680,324, was decreased by $8,679,667. Uninsured accident and health plan aggregate and specific stoploss claim payments made directly to health care providers were improperly included in this account. Payments were applied against the Association's liability for accident and health policy and contract claims.

(6) Aggregate reserve for life policies and contracts **$ 1,339,496**

The reported amount, $832,025, was increased by $507,471. The increase resulted primarily from the establishment of a reserve for a block of individual one and five year term policies "taken over" by Johnson Rooney Welch, Inc. The take over did not meet the requirements of U.C.A. § 31A-17-404 for reserve credit.

(7) <u>Aggregate reserve for accident and health policies</u> **<u>$ 10,351,491</u>**

The reported amount, $8,841,938, was increased by $1,509,553. The increase resulted primarily from a retrospective development of incurred but not reported ("IBNR") and in course of settlement ("ICOS") long-term disability and waiver of premium claims incurred prior to January 1, 2002. The methodology used by the Association to estimate the IBNR and ICOS reserve materially understated the liability.

(8) <u>Liability for deposit-type contracts</u> **<u>$ 0</u>**

In accordance with APPM SSAP No. 55, three death claims in the course of settlement for underage beneficiaries in the aggregate amount of $15,976 were reclassified to "Policy and contract claims – life". In addition, an entry in the amount of $3,758 erroneously credited to this account was reversed. The reversal resulted in a direct charge to surplus because the asset account credited by the Association was nonadmitted.

(9) <u>Policy and contract claims – life</u> **<u>$ 20,976</u>**

In accordance with APPM SSAP No. 55, three death claims in the course of settlement for underage beneficiaries in the aggregate amount of $15,976 were reclassified from "Liability for deposit-type contracts". In addition, a retrospective development of death claims incurred prior to January 1, 2002, and paid between January 1, 2002, and December 31, 2002, identified one death claim in the amount of $5,000.

(10) <u>Policy and contract claims – accident and health</u> **<u>$ 12,301,568</u>**

The amount reported, $24,027,820, was decreased by specific and aggregate medical stoploss claim payments made directly to health care providers in the amount of $11,726,252. Payments in the amount of $8,679,667 reported as "Amounts receivable relating to uninsured accident and health plans" and payments in the amount of $3,046,585 offset against "Liability for amounts held under uninsured accident and health plans" were applied against this liability.

(11) <u>Premiums and annuity considerations for life and accident and health policies and contracts received in advance</u> **<u>$ 311,490</u>**

The amount reported, $504,359, was decreased by $192,869. A misallocated payment in the amount of $28,121 was reclassified to "Remittances and items not allocated. NAIC APPM SSAP No. 67 specifies that cash receipts that cannot be identified for a specific purpose, or for other reasons, applied to a specific account when received should be reported as remittances and items not allocated. Cash receipts in the amount of $164,748 received from ASC plans for various items related to uninsured accident and health plans were reclassified to "Liability for amounts held under uninsured accident and health plans". NAIC APPM SSAP No. 47 specifies that a liability shall be established for funds held by an administrator in its general assets for the benefit of uninsured plans. NAIC Annual Statement Instructions require that this liability be included in the liability for amounts held under uninsured accident and health plans.

(12) <u>Other amounts payable on reinsurance</u> **<u>$ 94,855</u>**

Reinsurance premiums payable and reinsurance settlement balances were reclassified from "Aggregate write-ins for liabilities: reinsurance payable". Annual statement instructions specify that write-in lines are to be used when an item cannot be readily classified under one of the printed categories.

(13) <u>General expenses due or accrued</u> **<u>$ 1,493,160</u>**

Sick leave and vacation payable in the amount of $457,424 and the liability for unfunded employee postretirement benefits in the amount of $780,747 were reclassified from "Liability for benefits for employees and agents if not included above". In addition, miscellaneous general expenses in the amount of $12,673 were reclassified from "Aggregate write-ins for liabilities: accounts payable". Annual statement instructions specify that write-in lines are to be used when an item cannot be readily classified under one of the printed categories.

(14) <u>Amounts withheld or retained by company as agent or trustee</u> **<u>$ 1,309,963</u>**

Funds in the amount of $25,176 received from a school district to pay district employee benefits were reclassified from "Aggregate write-ins for liabilities: accounts payable".

(15) <u>Remittances and items not allocated</u> **<u>$ 28,121</u>**

A misallocated payment in the amount of $28,121 was reclassified from "Premiums and annuity considerations for life and accident and health policies and contracts received in advance". NAIC APPM SSAP No. 67 specifies that cash receipts that cannot be identified for a specific purpose, or for other reasons, applied to a specific account when received should be reported as remittances and items not allocated.

(16) <u>Liability for benefits for employees and agents if not included above</u> **<u>$ 0</u>**

Vacation and sick leave payable in the amount of $457,424 and the liability for unfunded employee postretirement benefits in the amount of $780,747 were reclassified to "General expenses due or accrued".

(17) <u>Payable to parent, subsidiaries and affiliates</u> **<u>$ 75,449</u>**

Miscellaneous amounts due subsidiaries, $15,904, were reclassified from "Aggregate write-ins for liabilities: accounts payable". Annual statement instructions specify that write-in lines are to be used when an item cannot be readily classified under one of the printed categories.

(18) <u>Liability for amounts held under uninsured accident and health plans</u> **<u>$ 4,975,841</u>**

The amount reported, $1,764,508, was increased by $3,211,333. Uninsured accident and health plan aggregate and specific stoploss claim payments made directly to health care providers in the amount of $3,046,585 were improperly offset against this account. The offset was reversed and applied against the Association's liability for accident and health policy and contract claims.

In addition, $164,748 received in advance from uninsured accident and health plans was reclassified from "Premiums and annuity considerations for life and accident and health policies and contracts received in advance".

(19) <u>Aggregate write-ins for liabilities: accounts payable</u> **<u>$ 33,307</u>**

The reported amount, $178,537, was reduced by $145,230. An incorrect accounting entry that overstated cash and accounts payable by $91,477 was reversed. In addition, several miscellaneous accounts payable were reclassified to annual statement printed lines. Annual statement instructions specify that write-in lines are to be used when an item cannot be readily classified under one of the printed categories. The following reclassifications were made:

Payable to parent, subsidiaries and affiliates	$15,904
General expenses	12,673
Amounts withheld or retained by company as agent or trustee	25,176
Total	$53,753

(20) <u>Aggregate write-ins for liabilities: reinsurance payable</u> **<u>$ 0</u>**

The reported amount, $94,855, was reclassified to "Other amounts payable on reinsurance". This account consisted of reinsurance premiums payable and reinsurance settlement balances. Annual statement instructions specify that write-in lines are to be used when an item cannot be readily classified under one of the printed categories.

Refer to the following page for changes to Surplus.

(21) Surplus **$ 13,446,489**

The Association's surplus was determined to be $1,696,068 less than reported. The following schedule identifies examination changes:

Description	Annual Statement Dr (Cr)	Examination Dr (Cr)	Reclass-ification Dr (Cr)	Change in Surplus Inc (Dec)	Notes
Common stocks	$ 2,809,175	$ 2,895,823		$ 86,648	(1)
Real estate: Properties occupied by the company	1,426,079	1,391,629		(34,450)	(2)
Cash and short-term investments	14,457,876	14,366,399	(91,477)	0	(3)
Life insurance premiums and annuity considerations deferred and uncollected	0	270,000		270,000	(4)
Amounts receivable relating to uninsured accident and health plans	8,680,324	657	(8,679,667)	0	(5)
Aggregate reserve for life policies and contracts	(832,025)	(1,339,496)		(507,471)	(6)
Aggregate reserve for accident and health policies	(8,841,938)	(10,351,491)		(1,509,553)	(7)
Liability for deposit-type contracts	(19,734)	0	15,976	3,758	(8)
Policy and contract claims – life	0	(20,976)	(15,976)	(5,000)	(9)
Policy and contract claims – accident and health	(24,027,820)	(12,301,568)	11,726,252	0	(10)
Premiums and annuity considerations for life and accident and health policies and contracts received in advance	(504,359)	(311,490)	192,869	0	(11)
Other amounts payable on reinsurance	0	(94,855)	(94,855)	0	(12)
General expenses	(242,316)	(1,493,160)	(1,250,844)	0	(13)
Amounts withheld or retained by company as agent or trustee	(1,284,787)	(1,309,963)	(25,176)	0	(14)
Remittances and items not allocated	0	(28,121)	(28,121)	0	(15)
Liability for benefits for employees and agents if not included above	(1,238,171)	0	1,238,171	0	(16)
Payable to parent, subsidiaries and affiliates	(59,545)	(75,449)	(15,904)	0	(17)
Liability for amounts held under uninsured accident and health plans	(1,764,508)	(4,975,841)	(3,211,333)	0	(18)
Accounts payable	(178,537)	(33,307)	145,230	0	(19)
Reinsurance payable	(94,855)	0	94,855	0	(20)
Total changes			$ 0	(1,696,068)	
Surplus per company				15,142,557	
Surplus per examination				$13,446,489	(21)

U.C.A. § 31A-5-211 required the Association to maintain minimum capital in the amount of $400,000. In accordance with U.C.A. 31A-17 Part VI, the Association reported total adjusted capital in the amount of $15,923,450 and its authorized control level Risk-Based Capital ("RBC") in the amount of $4,503,484. The examination determined total adjusted capital to be $14,227,382 and accepted the Association's calculation of its authorized control level RBC. Examination adjustments would not have a material effect on the authorized control level RBC calculation.

The Association engaged legal representation in response to a U.S. Department of Health and Human Services, Office of Inspector General document subpoena, dated November 8, 2002. The subpoena focuses on the Association's compliance with certain provisions of the Medicare Secondary Payer Statute and implementing regulations. The Association has produced and continues to produce relevant documents. In addition, the U.S. Department of Justice and the U.S. Attorney's Office for the District of Utah have informed the Association that it is a named defendant in a related qui tam action in the United States District Court for the District of Utah. Because all pleadings in that action remain under seal, the precise nature of the Complaint and the magnitude of possible damages asserted therein, or that ultimately may be asserted are not presently known. The Association will vigorously defend any and all allegations averred against it but will seek an advantageous out-of-court settlement.

SUMMARY

Items of significance or special interest contained in this report are summarized below:

(1) The previous examination reduced reported surplus by $4,120,648. The adjustments resulted in the Association incurring an authorized control level event. As of the current examination date, the Association's total adjusted capital significantly exceeded the Risk-Based Capital trigger point for regulatory action. (**SCOPE OF EXAMINATION** – Status of Adverse Findings, Material Changes in the Financial Statement, and Other Significant Regulatory Information Disclosed in the Previous Examination)

(2) The Association operates under U.C.A. § 31A-5-108. The Association is authorized to transact life, annuity, and accident and health lines of insurance. (**HISTORY** – General)

(3) Several members of the board of directors identified interests that may give actual or potential conflict with their duties or judgment as an employee of the Association. (**HISTORY** – Conflict of Interest Procedure)

(4) The Association is a member of an insurance holding company system. **(AFFILIATED COMPANIES)**

(5) The Association did not notify the Commissioner in writing of its intention to enter into the 2001 EASI management agreement nor was the Commissioner notified of amendments to other management agreements at least 30 days prior to entering into the agreement and amendments as required by U.C.A. § 31A-16-106(1)(b)(iv). **(AFFILIATED COMPANIES)**

(6) During the examination period, the Association transitioned its accident and health medical plan of operation from fully insured plans to self-funded Administrative Service Only ("ASO") and Administrative Service Contract ("ASC") plans with specific and aggregate stop loss insurance coverage available. **(INSURANCE PRODUCTS AND RELATED PRACTICES** – Territory and Plan of Operation)

(7) Effective January 1, 1999, the Association entered into an agreement with EHC to assume 100 percent of certain group medical plans issued to educational groups and affiliated organizations. **(REINSURANCE)**

(8) Several accounts and records deficiencies were identified. As also noted in the previous examination report, several annual statement exhibits and schedules were determined to be deficient or improperly prepared. **(ACCOUNTS AND RECORDS)**

(9) Material adjustments and reclassifications were made to reported balance sheet amounts. **(COMMENTS ON FINANCIAL STATEMENT)**

(10) The Association engaged legal representation in response to a U.S. Department of Health and Human Services, Office of Inspector General document subpoena, dated November 8, 2002. The subpoena focuses on the Association's compliance with certain provisions of the Medicare Secondary Payer Statute and implementing regulations. In addition, the U.S. Department of Justice and the U.S. Attorney's Office for the District of Utah have informed the Association that it is a named defendant in a related qui tam action in the United States District Court for the District of Utah. **(COMMENTS ON FINANCIAL STATEMENT)**

CONCLUSION

Assistance and cooperation extended during the course of the examination by officers, employees, and representatives of the Association are acknowledged. In addition to the undersigned, Donald R. Catmull, Financial Examiner, participated in the examination. John Kay, CFE, CIE, Assistant Chief Examiner, supervised the examination.

Respectfully submitted,

C. Kay Anderson

C. Kay Anderson, CFE
Examiner-in-charge, Representing the
Utah Insurance Department